

**Office of Chief Counsel
Internal Revenue Service
memorandum**

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date: May 11, 2010

to: Laura Pinto
Attorney
Estate & Gift Tax

from: Susan T. Mosley
Senior Technician Reviewer
(Procedure & Administration)

subject: Equitable Remedies and Time-Barred Gift Tax

This memorandum responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

Date 1 =

Year A =

Year B =

Year C =

Year D =

Year E =

f =

g =

h =

i =

j =

ISSUES

1. Whether the recent grant of statutory authority to the Tax Court to apply the equitable recoupment doctrine under section 6214(b), as amended by the Pension Protection Act of 2006, affects the conclusions reached in FSA 200118002. FSA 200118002 addressed a situation in which an estate included gift tax that was not timely assessed, and therefore not paid, in determining the amount of “gift tax paid or payable” on the estate’s tax return.
2. Whether the Service may assert the equitable remedies of duty of consistency or equitable estoppel in a situation in which an estate includes gift tax that was not timely assessed, and therefore not paid, in determining the amount of “gift tax paid or payable” on the estate’s tax return.

CONCLUSIONS

1. No, the 2006 grant of statutory authority to the Tax Court to apply the equitable recoupment doctrine does not change the conclusions reached in FSA 200118002 as they pertain to this case.
2. No, the Service should not assert the equitable remedies of duty of consistency and equitable estoppel in this case.

FACTS

Decedent died on Date 1. Decedent’s estate timely filed a Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return. On that return, on Line 4, Part 2, Tax Computation, the estate reported “adjusted taxable gifts” in the amount of \$f. “Adjusted taxable gifts” are the total taxable gifts (within the meaning of section 2503) made by the decedent after December 31, 1976, other than gifts that are includible in decedent’s gross estate. On Line 7, Part 2, Tax Computation, the estate reported \$g as the “total gift tax paid or payable with respect to gifts made by the decedent after December 31, 1976.”¹ On Line 20 of the return, the estate reported a balance due of \$h.

In Year A, the Service selected the estate’s tax return for examination, having concluded that the estate had incorrectly reported the amount of decedent’s “adjusted

¹ Hereinafter, this deduction will be referred to as “gift tax paid or payable.”

taxable gifts.” The Service based this conclusion on decedent’s erroneous Year B Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return. On that return, Line 19, Part 2, Tax Computation, decedent reported gift tax due in the amount of \$g. Upon further review, decedent should have reported gift tax in the amount of \$i. The discrepancy arose from the decedent’s failure to properly report gift taxes stemming from gift tax returns filed in Year C, Year D, and Year E. When the adjustment is made to the estate’s tax return to account for this discrepancy, the resulting deficiency is \$j. This deficiency calculation includes a correlating increase in the estate’s deduction for “gift tax paid or payable.” It is our understanding that the limitations period now bars assessment of the gift tax decedent failed to report on its Year B gift tax return.

LAW AND ANALYSIS

You have asked our assistance with regard to whether the Service may use equitable recoupment or other equitable remedies to recoup the gift tax that was not timely assessed and therefore not paid, but nevertheless was utilized in the determination of “gift tax paid or payable” on the estate’s tax return. As noted in your request for advice, our office previously addressed a similar issue in 2001, for which we issued Field Service Advice (FSA) 200118002. In that FSA, our office determined the Service could not set use equitable recoupment because, in our view, the Tax Court did not have the authority to apply that doctrine. The FSA did suggest, however, that other equitable remedies might be available to the Service to recoup the time-barred gift tax. You have asked us to reconsider our conclusions based on the 2006 grant of statutory authority to the Tax Court to apply equitable recoupment. For the reasons set forth below, we will follow the conclusions set forth in FSA 200118002, even in light of the Tax Court’s statutory authority to apply the equitable recoupment doctrine. Additionally, we conclude that the Service should not assert the equitable remedies of duty of consistency or equitable estoppel under the circumstances set forth below.

FSA 200118002 addressed a factual situation wherein an estate included Year 1 gifts in computing its “gift tax paid or payable” under section 2001(b)(2) even though the Year 1 gifts were not included in calculating gift tax paid for taxable years Year 2, Year 3, and Year 4. At the time the estate filed its return, assessment of the Year 1 gifts taxes was barred. The FSA concluded that while the estate would be unjustly enriched by inclusion of the Year 1 gifts in determining the “gift tax paid or payable,” equitable recoupment could not be asserted. The FSA based this conclusion primarily on the National Office’s view that the Tax Court lacked the authority to apply the equitable recoupment doctrine.

After the issuance of FSA 200118002, the Congress, in 2006, granted the Tax Court the authority to apply equitable recoupment to the extent the remedy is available in civil tax cases before the District Courts and the Court of Federal Claims. I.R.C. § 6214(b), as amended by the Pension Protection Act of 2006, Pub. L. No. 109-280. We conclude that, though our office’s reasoning in the FSA was substantially based on the Tax Court’s lack of authority to apply equitable recoupment, the subsequent grant of

authority to the Tax Court does not change our conclusion that equitable recoupment does not permit the Service to collect the time-barred gift tax.

As explained in FSA 200118002 and in your request for advice, the doctrine of equitable recoupment requires proof of four elements:

- (1) [T]hat the refund or deficiency for which recoupment is sought by way of offset is barred by time;
- (2) that the time-barred offset arises out of the same transaction, item, or taxable event as the overpayment or deficiency;
- (3) that the transaction, item, or taxable event has been inconsistently subject to two taxes; and
- (4) that if the subject transaction, item, or taxable event involves two or more taxpayers, there is sufficient identity of interest between the taxpayers subject to the two taxes so that the taxpayers should be treated as one.

FSA 200118002 (citing and discussing Bull v. United States, 295 U.S. 247 (1935); Stone v. White, 301 U.S. 532 (1937); McEachern v. Rose, 302 U.S. 56 (1937); and Rothensies v. Electric Storage Battery Co., 329 U.S. 296, 302 (1946)). “Use of equitable recoupment is limited to defending against a valid claim. It allows an otherwise time-barred claim arising out of the same transaction to be used as a defense or credit against any additional tax.” Estate of Mueller v. Commissioner, 107 T.C. 189, 198 (1996) (emphasis added). Further, “the party asserting equitable recoupment may not affirmatively collect the time-barred underpayment or overpayment of tax. Equitable recoupment ‘operates only to reduce a taxpayer’s timely claim for a refund or to reduce the government’s timely claim of deficiency.’” Estate of Mueller v. Commissioner, 101 T.C. 551, 552 (quoting O’Brien v. United States, 766 F.2d 1038, 1049 (7th Cir. 1985)).

Under the facts as presented to us in your request for advice, the Service has determined a deficiency of \$j based on an upward adjustment in the estate’s “adjusted taxable gifts” and a correlating adjustment in its “gift tax paid or payable.” Upon timely issuance of a notice of deficiency and a timely petition under section 6213, the estate could then contest the Service’s determination in the Tax Court. Because the issue before the Tax Court would be the validity of the Service’s determination, as opposed to the estate’s claim for a refund of taxes already paid, there would be no amount against which the Service could assert the time-barred gift tax. An argument based on equitable recoupment under these circumstances would therefore be offensive rather than defensive in posture. This type of affirmative collection of tax does not square with the purposes behind the equitable recoupment doctrine. See Mueller, 101 T.C. at 552 (“[P]arty asserting equitable recoupment may not affirmatively collect the time-barred underpayment or overpayment of tax.”). In addition, while it is true that the doctrine of equitable recoupment is designed “to prevent inequitable windfalls,” it is only those windfalls resulting “from inconsistent tax treatment of a single transaction, item, or event” that the doctrine is designed to remedy. Here, the use of the time-barred gift tax in determining “gift tax paid or payable” is not necessarily inconsistent with the exclusion

from the decedent's gift tax returns. If anything, this inconsistency is statutory and should not be redressed through equitable means. Furthermore, as noted in the FSA, but for the equitable recoupment argument, there would be no basis for recovering the time-barred gift tax. Equitable recoupment cannot be the sole basis for jurisdiction. United States v. Dalm, 494 U.S. 596, 608 (1990). While the Tax Court would have jurisdiction over the estate's deficiency, that jurisdiction would result from the Service's own deficiency determination. Effectively, by issuing the statutory notice the Service would be boot-strapping itself into a position where it could both assess the deficiency as well as recoup the gift tax in the same Tax Court proceeding. This too does not harmonize with the purposes behind the equitable recoupment doctrine.

We similarly conclude that the Service should not assert the equitable remedies of duty of consistency or equitable estoppel in this case.

The duty of consistency is an equitable doctrine that Federal courts will employ to prevent "unfair tax gamesmanship." Hollen v. Commissioner, T.C. Memo. 2000-99; Cluck v. Commissioner, 105 T.C. 324 (1995). The doctrine "is based on the theory that the taxpayer owes the Commissioner the duty to be consistent . . . and will not be permitted to benefit from the taxpayer's own prior error or omission." Cluck, 105 T.C. at 331. The doctrine requires proof of three elements: (1) the taxpayer has made a representation in one year; (2) the Service has acquiesced in or relied on that representation for that year; and (3) the taxpayer desires to change that representation in a later year at a time when the period of limitations bars adjustments to the prior year. See id. at 332; LeFever v. Commissioner, 103 T.C. 525, 543 (1994). Here, decedent filed a Year B gift tax return reporting a gift tax due amount of \$g, which failed to account for prior gift tax. Likewise, on its return, the estate reported a "gift tax paid or payable" amount of \$g. While the Service "acquiesced in" the decedent's position on the Year B gift tax return, it is not the decedent (or the estate) who now desires to change that representation. Rather, it is the Service who is making this adjustment to the "gift tax paid or payable" amount to correlate with the upward adjustment in the estate's "adjusted taxable gifts." Further, any duty of consistency argument raised by the Service would be an attack on the treatment of the gift tax in the prior year's return, not the later year which would be at issue in the deficiency proceeding. By raising the consistency argument before the Tax Court, the Service would, in effect, be arguing for an adjustment to the decedent's representation in a prior, closed year rather than advocating the Court to preclude the decedent's estate from taking an inconsistent position in the later year. Such relief is not the type of remedy afforded by the duty of consistency doctrine.

For similar reasons, the Service should not assert the doctrine of equitable estoppel. Equitable estoppel requires the government to demonstrate that: (1) the taxpayer made a false representation; (2) the representation is a statement of fact, not of law; (3) the government reasonably relied on the taxpayer's representation; and (4) the government was not aware of the true facts. Union Tex. Int'l Corp. v. Commissioner, 110 T.C. 321, 327 (1998). Here, the Service would not be arguing that the estate should be estopped

from including the time-barred gift tax in its calculation of the “gift tax paid or payable” amount. It is our understanding that this adjustment is necessary in light of the corresponding adjustment to the estate’s “adjusted taxable gifts.” Rather, the Service is arguing that the decedent’s representation as to the “gift tax due” on the Year B gift tax return allows the Service to recoup the otherwise time-barred gift tax. This type of relief is not contemplated by the equitable estoppel doctrine.

Accordingly, we conclude that the 2006 grant of statutory authority to the Tax Court to apply equitable recoupment does not alter our conclusions set forth in FSA 200118002. Furthermore, we conclude that the equitable remedies of duty of consistency and equitable estoppel do not apply in this case.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call (202) 622-7950 if you have any further questions.